

OIL AND GAS LEASE
(No Surface Use)

THE STATE OF TEXAS §
COUNTY OF TARRANT §

THIS AGREEMENT ("Lease") is made and entered into as of the date herein specified by and between **GATEWAY PUBLIC FACILITY CORPORATION**, a Texas public facility corporation (hereinafter referred to as "Lessor"), and, **VARGAS ENERGY, LTD.**, a Texas limited partnership (hereinafter referred to as "Lessee").

WITNESSETH:

1.

GRANTING CLAUSE

Lessor, in consideration of a cash bonus in hand paid, of the royalties herein provided, and of the agreements of Lessee hereinafter contained, hereby grants, leases, and lets exclusively unto Lessee for the sole purpose of investigating, exploring, drilling, operating, and producing oil and/or gas from the land leased hereunder, together with any liquid or gaseous substances produced in association with oil and gas, the following described land situated in the City of Fort Worth, Texas described in Exhibit "A" attached hereto (the "leased premises").

All mineral substances and mineral rights other than oil and gas (and all other liquid or gaseous minerals produced in association with oil or gas) are expressly reserved to Lessor and excepted from this Lease. These reserved mineral rights include, but are not limited to, the rights to lignite, coal and sulfur not produced as a component of oil and gas.

For the purpose of determining the amount of any bonus or other payment hereunder, said leased premises shall be deemed to contain 22.2197 acres, whether actually containing more or less.

2.

PRIMARY TERM

Subject to the other provisions herein contained, this Lease shall be for a term of two (2) years from the date of the notarial acknowledgment of Lessor's execution of this instrument (hereinafter called "primary term") and so long thereafter as oil, gas or other minerals granted herein are produced from the leased premises or lands pooled therewith, in paying quantities, or drilling operations are in progress thereon as hereinafter provided, and the royalties are paid as provided herein.

3.

DELAY RENTALS

If actual drilling is not commenced on the leased premises or on any lands pooled therewith on or before twelve (12) months from the date of this Lease, this Lease shall automatically terminate, unless on or before such anniversary date Lessee shall pay to Lessor or to the credit of Lessor, the sum of FOUR HUNDRED FORTY-FOUR AND 39/100 DOLLARS (\$444.39) (hereinafter called "rental") which shall cover the privilege of deferring commencement of drilling operations for a period of twelve (12) months. In like manner, and upon like payments annually, the commencement of drilling operations may be further deferred for successive periods of twelve (12) months each during the primary term. The payment of rentals may be made by the check of Lessee delivered to Lessor on or before such date of payment. If the rental is not paid on or before the date it is due, then this Lease will automatically terminate. Upon termination, Lessee shall prepare, execute and deliver to Lessor a recordable release covering the leased premises in accordance with this Lease. Lessee may at any time or times execute and deliver to Lessor, a release or releases of this Lease as to all or any part of the leased premises, and thereby be relieved of all obligations as to the released land or

interest, except for the indemnification obligations described in Section 16 and the plugging obligations of this Lease. If a portion of the lands covered by this Lease is released, the rentals and shut-in royalty payments computed in accordance therewith shall be reduced by the proportion that the number of surface acres within such released portion bears to the total number of surface acres which were covered by this Lease immediately prior to such release. The bonus paid hereunder is consideration for this Lease and not rental for a period.

4.

ROYALTIES

Lessee shall pay to Lessor the following royalties, which shall be free of all costs of any kind, including, but not limited to, costs of gathering, production, transportation, treating, compression, dehydration, processing, marketing, trucking or other expense, directly or indirectly incurred by Lessee, whether as a direct charge or a reduced price or otherwise. In this regard, Lessee agrees to bear one hundred percent (100%) of all costs and expenses incurred in rendering hydrocarbons produced on or from the leased premises marketable and delivering the same into the purchaser's pipeline for immediate transportation to an end user or storage facility. Additionally, said royalties shall never bear, either directly or indirectly, under any circumstances, the costs or expenses (including depreciation) to construct, repair, renovate or operate any pipeline, plant, or other facilities or equipment used in connection with the treating, separation, extraction, gathering, processing, refining, compression, transporting, manufacturing or marketing of hydrocarbons produced from the leased premises or lands pooled therewith.

A. On oil, gas (including flared gas) and casinghead gas, together with any other liquid or gaseous hydrocarbons recovered by Lease operations (such as in drips or separators) twenty five percent (25%) of the proceeds of the sale or of the market value thereof, whichever is higher. Such proceeds of oil, gas and casinghead gas, together with any other liquid or

gaseous hydrocarbons recovered by Lease operations, is to be delivered free of cost at the well or to the credit of the Lessor into pipelines, gathering lines, barges or other facilities to which the wells and tanks on the property may be connected. Lessor shall always have the right, at any time and from time to time, upon reasonable written notice to Lessee, to take Lessor's share of oil, gas and processed liquids in kind. Lessor may elect to take Lessor's gas in kind at the well, or at the point of delivery where Lessee delivers Lessee's gas to any third party. If gas is processed, Lessor may elect to take Lessor's share of the residue gas attributable to production from the leased premises, at the same point of delivery where Lessee receives its share of residue gas or has its share of residue gas delivered to a third party. Lessor may elect to have its royalty share of processed liquids stored in tanks at the plant or delivered into pipelines on the same basis as Lessee's share of liquids is stored or delivered. Lessor shall reimburse Lessee for all reasonable costs incurred by Lessee in installing, operating or maintaining additional facilities necessary for Lessor's royalty gas and processed liquids to be separately metered, accounted for, and delivered to a third party, but Lessor shall not be charged for any expense in the production, gathering, dehydration, separation, compression, transportation, treatment, processing or storage of Lessor's share of gas and processed liquids.

B. On products, twenty five percent (25%) of the gross market value or proceeds of sale thereof, whichever is higher.

C. On residue gas or gas remaining after separation, extraction or processing operations, twenty five percent (25%) of the proceeds of sale or of the market value thereof, whichever is higher.

D. For purposes of this Paragraph 4, the term "market value" shall mean for gas and products therefrom (i) the gross price at which gas or products therefrom are sold pursuant to a

Gas Contract, as defined below, that is ratified by Lessor according to Paragraph G below or (ii) if not sold pursuant to a Gas Contract, as defined below, ratified by Lessor and Lessee, the highest gross price reasonably obtainable for the quantity of gas or products available for sale, through good faith negotiations for gas or products produced from the leased premises at the place where such gas or product is available for sale on the date of such a contract with adequate provisions for redetermination of price at intervals of no less frequency than one (1) year to ensure that the production is being sold for no less than the current market price. Included within the definition of "Market Value" as used herein is the presumption that Gas Contracts that are ratified by Lessor are arms-length contracts with purchasers who are not affiliates of Lessee. An "affiliate" includes, but is not limited to, the parent company or a subsidiary of Lessee, a corporation or other entity having common ownership with Lessee, a partner or joint venturer of Lessee with respect to the ownership or operation of the processing plant, a corporation or other entity in which Lessee owns a ten percent (10%) or greater interest, or any individual, corporation or other entity that owns a ten percent (10%) or greater interest in Lessee. In no event shall "market value" ever be less than the amount actually received by the Lessee for the sale of hydrocarbons.

E. This Lease is intended to cover only oil and gas, but some other substances (including helium and sulphur) may be produced necessarily with and incidental to the production of oil or gas from the leased premises; and, in such event, this Lease shall also cover all such other substances so produced. On all such substances so produced under and by virtue of the terms of this Lease, Lessor shall receive a royalty of twenty five percent (25%) of all such substances so produced and saved, same to be delivered to Lessor, free of all costs; or, at Lessor's election, Lessor's twenty five percent (25%) of such substances shall be sold by Lessee

with Lessee's portion of such substances and at the same profit realized by Lessee for its portion of such substances.

F. All royalties hereinabove provided shall be payable in cash (unless Lessor elects to take such royalty oil or gas in kind) to Lessor within sixty (60) days following the first commercial sale of production and thereafter no more than thirty (30) days after the end of the month following the month during which production takes place. Subject to the provisions of Paragraph 10 of this Lease concerning shut-in wells, royalties shall be paid to Lessor by Lessee and/or its assigns or by the product purchaser for oil and/or gas. Upon the failure of any party to pay Lessor the royalty as provided in this paragraph, Lessor may, at Lessor's option, elect to terminate this Lease by sending written notice to Lessee. Lessee shall then have thirty (30) days from the date of service of such written notice in which to avoid termination of this Lease by making or causing to be made the proper royalty payment or payments that should have been paid. If such royalty payment is not made on or before the expiration of the thirty (30) day period, or written approval is not obtained from Lessor to defer such payment, Lessor may elect to terminate this Lease by filing a Notice of Termination with the County Clerk in the county where the leased premises are located. The effective date of said termination shall be the date said Notice of Termination is filed with the said County Clerk. If a royalty is not paid when due, and Lessor does not terminate the Lease as provided above, Lessor's royalty will bear interest at the maximum lawful rate from the due date until paid. Acceptance by Lessor of royalties that are past due will not act as a waiver or estoppel of its right to receive interest due thereon. The receipt by Lessee from a purchaser or a pipeline company of proceeds of production for distribution to Lessor will not result in Lessee acquiring legal or equitable title to Lessor's share of those proceeds and Lessee will at all times hold Lessor's share of those

proceeds in trust for the benefit of Lessor. Notwithstanding the insolvency, bankruptcy, or other business failure of a purchaser of production from the leased premises or pipeline company transporting production from the leased premises, Lessee will remain liable for timely payment to Lessor for, and agrees to pay Lessor, all royalties due Lessor, together with interest if not timely paid.

G. Lessee agrees that it will not enter into any contract for the sale, delivery, transporting or processing of gas produced from the leased premises which shall extend more than two (2) years from the effective date of such sales contract unless such contract has adequate provisions for redetermination of price at intervals of no less frequency than one (1) year to ensure that production from this Lease is not being sold for less than the then current market value. At least thirty (30) days prior to the delivery or the execution of any contract for the sale, delivery, transporting or processing of gas produced from the leased premises, Lessee shall provide Lessor with a complete copy of each proposed contract for the purchase, transportation and/or processing of such gas that Lessee intends to execute (each a "Gas Contract"), whereupon, Lessor shall have fifteen (15) days within which to either ratify such Gas Contract or notify Lessee in writing that it does not approve of such Gas Contract, including a statement of the reasons that Lessor does not approve of such Gas Contract (Lessor's failure to respond within the fifteen (15) days either by ratification or by written notice that it does not approve of the proposed Gas Contract shall be deemed to be Lessor's ratification of such Gas Contract). If Lessor ratifies the Gas Contract, Lessor shall be deemed bound by the terms of such Gas Contract (and, at Lessee's option, Lessor shall execute such Gas Contract as a party thereto) and the gas or products therefrom sold pursuant to such Gas Contract shall be deemed sold at market value based on the gross price stated therein. Lessee shall not amend or modify

any material terms of a Gas Contract ratified by Lessor without the prior written consent of Lessor. If Lessor does not approve of a Gas Contract, Lessee shall consult with Lessor in an effort to agree to the terms of the proposed Gas Contract, and if the other party or parties to the Gas Contract agree to the changes or modifications to the Gas Contract which are proposed by Lessor in order for Lessor to ratify such Gas Contract, then Lessor shall be deemed to have ratified such Gas Contract (and, at Lessee's option, Lessor shall execute such Gas Contract as amended and modified, as a party thereto). If Lessor and Lessee cannot agree on the terms of a Gas Contract that are acceptable to the other party or parties thereto, Lessee may elect to execute such Gas Contract and sell, deliver, transport and process gas according to the terms thereof, subject to the other terms of this Paragraph 4 concerning the payment of Lessor's royalty on gas and products there from, including the right of Lessor to take its share of gas in kind. In the event Lessor elects to take and separately dispose of its royalty share of gas, the parties shall enter into a mutually acceptable balancing agreement providing for (a) the right of an under produced party to make up an imbalance by taking up to 150 percent (150%) of its share of production and (b) and obligation to settle any imbalance remaining after depletion in cash, based on the proceeds received by the overproduced party when the imbalance was created, or if the overproduced party's gas was used but not sold, based on the market value of the gas when imbalance was created.

H. In the event Lessee enters into a gas purchase contract which contains what is commonly referred to as a "take or pay provision" (such provision meaning that the gas purchaser agrees to take delivery of a specified minimum volume or quantity of gas over a specified term at a specified price or to make minimum periodic payments to the producer for gas not taken by the purchaser) and the purchaser under such gas purchase contract makes

payment to Lessee by virtue of such purchaser's failure to take delivery of such minimum volume or quantity of gas, then Lessor shall be entitled to twenty five percent (25%) of all such sums paid to Lessee or producer under the "pay" provisions of such gas purchase contract. Such royalty payments shall be due and owing to Lessor within thirty (30) days after the receipt of such payments by Lessee. If the gas purchaser "makes up" such gas within the period called for in the gas contract and Lessee is required to give such purchaser a credit for gas previously paid for but not taken, then Lessor shall not be entitled to royalty on such "make up" gas. If Lessee is not producing any quantities of gas from the leased premises but is receiving payments under the "pay" portion of such "take or pay" gas purchase contract provision, such payments shall not relieve Lessee of the duty to make shut-in royalty payments if Lessee desires to continue this Lease, but such "take or pay" royalty payments shall be applied as a credit against any shut-in royalty obligation of the Lessee. Lessor shall be a third-party beneficiary of any gas purchase contract and/or transportation agreement entered into between Lessee and any purchaser and/or transporter of Lessor's gas, irrespective of any provision of said contracts to the contrary, and such gas purchase contract and/or transportation agreement will expressly so provide. Further, Lessor shall be entitled to twenty-five percent (25%) of the value of any benefits obtained by or granted to Lessee from any gas purchaser and/or transporter for the amendment, modification, extension, alteration, consolidation, transfer, cancellation or settlement of any gas purchase contract and/or transportation agreement.

I. Lessee agrees that before any gas produced from the leased premises is used or sold off the leased premises, it will be run, free of cost to Lessor, through an adequate oil and gas separator of a conventional type or equipment at least as efficient, to the end that all liquid hydrocarbons recoverable from the gas by such means will be recovered and Lessor properly

compensated therefor.

J. Any payment of royalty or shut-in gas royalty hereunder paid to Lessor in excess of the amount actually due to the Lessor shall nevertheless become the property of the Lessor if Lessee does not make written request to Lessor for reimbursement within one (1) year from the date that Lessor received the erroneous payment, it being agreed and expressly understood between the parties hereto that Lessor is not the collecting agent for any other royalty owner under the lands covered hereby, and a determination of the name, interest ownership and whereabouts of any person entitled to any payment whatsoever under the terms hereof shall be the sole responsibility of Lessee. It is further expressly agreed and understood that: (i) this provision shall in no way diminish the obligation of Lessee to make full and punctual payments of all amounts due to Lessor or to any other person under the terms and provisions of this Lease, and (ii) any overpayments made to the Lessor under any provisions of this Lease shall not be entitled to be offset against future amounts payable to parties hereunder.

K. The terms of this Lease may not be amended by any division order and the signing of a division order by any mineral owner may not be made a prerequisite to payment of royalty hereunder.

L. Oil, gas or products may not be sold to a subsidiary or affiliate of Lessee as defined herein without the Lessor's prior written permission.

M. Lessee shall pay Lessor royalty on all gas produced from a well on the leased premises and sold or used off the leased premises, regardless of whether or not such gas is produced to the credit of Lessee or sold under a contract executed by or binding on Lessee. Should gas be sold under a sales contract not binding on Lessee, Lessor's royalty will be calculated based on the highest price paid for any of the gas produced from the well from

which such gas is produced. In no event will the price paid Lessor for Lessor's share of gas be less than the price paid Lessee for Lessee's share of gas.

N. If Lessee receives from a purchaser of oil or gas any reimbursement for all or any part of severance or production taxes, or if Lessee realizes proceeds of production after deduction for any expenses of production, gathering, dehydration, separation, compression, transportation, treatment, processing, storage, or marketing, then the reimbursement or the deductions will be added to the total proceeds received by Lessee.

O. Minimum Royalty. After production of oil or gas is obtained, and as long thereafter as this Lease is in force, Lessee agrees that the royalties that will be paid to Lessor will not be less than Ten Thousand Dollars (\$10,000) per lease year. Minimum royalties will be due within thirty (30) days after the anniversary date of the lease year during which production is first obtained, and within thirty (30) days after the anniversary date of each lease year thereafter. If royalties on actual production for a lease year do not exceed the minimum amount, Lessee shall pay to Lessor an amount equal to the specified minimum less the amount of royalties paid during the lease year. Amounts paid as shut-in royalties during a lease year will be credited toward the minimum royalty payment for the year. Payment of minimum royalties will not affect Lessee's implied covenants under this Lease or its obligation to protect from drainage.

5.

POOLING

Lessee, upon the prior written consent of Lessor which shall not be unreasonably withheld, is hereby given the right to pool or combine the acreage covered by this Lease as to oil and gas, or either of them, with any other land, lease or leases in the immediate vicinity thereof to the extent hereafter stipulated, when it is necessary or advisable to do so in order to properly

explore or develop, produce and operate said leased premises. A pooled unit for a well may not exceed the minimum size required to obtain a drilling permit under the well density rules adopted by the Railroad Commission of Texas for the field, or if there are no field rules that apply, the pooled unit shall be limited to the smallest size required to obtain a drilling permit under the statewide well density rules of the Railroad Commission of Texas. A pooled unit for a vertical well producing from the Barnett Shale formation will be twenty (20) acres. A pooled unit for a horizontal well may include the minimum acres permitted for a vertical well plus the additional acreage listed in the tables in Rule 86 (for fields with a density of forty (40) acres or less) and must comply with the requirements of Rule 86 for minimum permitted well density, and if the horizontal well is producing from the Barnett Shale formation, the acreage of the pooled unit shall be assigned as if well density for vertical wells is forty (40) acres or less. It is intended that the shape of the pooled unit will be a compact, regular shape that will provide Lessor with the maximum acreage available for oil and gas development. Lessee, under the provisions hereof, may pool or combine acreage covered by this Lease or any portion thereof as above provided as to oil in any one or more strata and as to gas in any one or more strata. The units formed by pooling as to any stratum or strata need not conform in size or area with the unit or units into which the Lease is pooled or combined as to any other stratum or strata, and oil units need not conform as to area with gas units. The pooling in one or more instances shall not exhaust the rights of the Lessee hereunder to pool this Lease or portions thereof into other units. Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing the pooled acreage as a pooled unit. In this regard, Lessee shall provide Lessor with a copy of any and all documents filed with any regulatory authority or recorded in the records of any county within thirty (30) days of filing such documents. Upon the

recordation of the unit in the county records and the timely furnishing of the copies required herein to Lessor the unit shall be effective as to all parties hereto, their heirs, successors, and assigns, irrespective of whether or not the unit is likewise effective as to all other owners of surface, mineral, royalty or other rights in land included in such unit. Lessee may at its election exercise its pooling option before or after commencing operations for or completing an oil or gas well on the leased premises, and the pooled unit may include, but it is not required to include, land or leases upon which a well capable of producing oil or gas in paying quantities has theretofore been completed or upon which operations for the drilling of a well for oil or gas have theretofore been commenced. In the event of operations for drilling on or production of oil or gas from any part of a pooled unit which includes all or a portion of the land covered by this Lease, such operations shall be considered as operations for drilling on or production of oil and gas from land covered by this Lease and included in the pooled unit whether or not the well or wells be located on the premises covered by this Lease and in such event operations for drilling shall be deemed to have been commenced on said land within the meaning of this Lease. For the purpose of computing the royalties to which owners of royalties and payments out of production and each of them shall be entitled on production of oil and gas, or either of them, there shall be allocated to the land covered by this Lease and included in said unit (or to each separate tract within the unit if this Lease covers separate tracts within the unit) a pro rata portion of the oil and gas, or either of them, produced from the pooled unit. Royalties hereunder shall be computed on the portion of such production, whether it be on oil and gas, or either of them, so allocated to the land covered by this Lease and included in the unit just as though such production were from such land. The production from an oil well will be considered as production from this Lease or oil pooled unit from which it is producing and not as production from a gas pooled unit; and

production from a gas well will be considered as production from this Lease or gas pooled unit from which it is producing and not from an oil pooled unit. The formation of any unit hereunder shall not have the effect of changing the ownership of any delay rental or shut-in production royalty which may become payable under this Lease. If this Lease now or hereafter covers separate tracts, no pooling or unitization of royalty interest as between any such separate tracts is intended or shall be implied or result merely from the inclusion of such separate tracts within this Lease but Lessee shall nevertheless have the right to pool as provided above with consequent allocation of production as provided above. As used in this paragraph, the words "separate tract" mean any tract with royalty ownership differing, now or hereafter, either as to parties or amounts, from that as to any other part of the leased premises. Notwithstanding anything to the contrary set forth above, no unit may be formed that is comprised of less than all of the acreage of the leased premises.

6.

CONTINUOUS DRILLING

At the expiration of the primary term this Lease shall remain in full force and effect for so long as Lessee is conducting Continuous Drilling Operations (as herein defined). Lessee shall be considered to be engaged in Continuous Drilling Operations at the expiration of the primary term if:

- (1) Lessee is then engaged in drilling operations on the leased premises or lands pooled therewith or
- (2) Lessee has completed a well as a producer or as a dry hole within ninety (90) days prior to the expiration of the primary term. Lessee also shall be considered to be engaged in Continuous Drilling Operations for so long thereafter as Lessee conducts drilling operations on the leased premises, or lands pooled therewith, with due diligence and with intervals of no more than ninety (90) days between the date of completion of one well and the date of commencement of drilling operations on an additional well. "Completion" shall be considered to be the date of release of the

completion rig for a completed well, but in no event more than ninety (90) days following the release of the drilling rig. In the case of a dry hole, "completion" shall be considered to be the date of release of the drilling rig. "Commencement" shall be the actual spud date of a well. Continuous Drilling Operations shall be deemed to have ceased upon the failure of Lessee to commence drilling operations on an additional well within such ninety (90) day period. When the Continuous Drilling Operations cease, the provisions of Paragraph 7 will be applicable.

7.

RETAINED ACREAGE

A. Vertical Wells

At the expiration of the primary term of this Lease or upon the termination of the continuous drilling program set forth in Paragraph 6, each non-horizontal well drilled hereon capable of producing in paying quantities will hold only forty (40) acres for any formation from the surface to the base of the Barnett Shale formation. As to depths below the base of the Barnett Shale Formation, the proration unit shall be the minimum size necessary to obtain the maximum production allowable. If the proration unit for a well completed below the base of the Barnett Shale Formation is larger than forty (40) acres, the well may maintain the Lease as to formations above the base of the Barnett Shale Formation as to not more than forty (40) acres. All other acreage except that included in a proration unit or pooled unit as described above will cease to be covered by this Lease and will be released. To the extent possible, each such proration unit will be in the shape of a square, with the bottom of the well in the center. Further, it is understood and agreed that Lessee shall earn depths as to each proration unit or pooled unit only from the surface down a depth which is the stratigraphic equivalent to a depth of one hundred (100) feet below the deepest producing formation in such well which is capable of producing oil and gas in

paying quantities at the expiration of the primary term of this Lease or upon the termination of the continuous drilling program set forth in Paragraph 6. This Lease will terminate at such time as to all depths below such depths as to each respective proration unit or pooled unit. If production should thereafter cease as to acreage included in a proration unit or pooled unit, this Lease will terminate as to such acreage unless Lessee commences reworking or additional drilling operations on such acreage within ninety (90) days thereafter and continues such reworking or additional drilling operations until commercial production is restored thereon, provided that if more than ninety (90) days elapse between the abandonment of such well as a dry hole and the commencement of actual drilling operations for an additional well, or more than ninety (90) days pass since the commencement of reworking operations without the restoration of commercial production, this Lease shall terminate as to the applicable proration unit or pooled unit.

At any time or times that this Lease terminates as to all or any portion of the acreage of the leased premises, Lessee shall promptly execute and record in the office of the County Clerk in the County where the leased premises are located, a proper release of such terminated acreage and shall furnish executed counterparts of each such release to Lessor at the address shown in Paragraph 19 hereof.

B. Horizontal Wells

It is expressly understood and agreed that, subject to the other terms, provisions and limitations contained in this Lease, Lessee shall have the right to drill "horizontal wells" under the leased premises, or lands pooled therewith. The term "horizontal well" or "horizontally drilled well" shall mean any well that is drilled with one or more horizontal drainholes having a horizontal drainhole displacement of at least five hundred eighty-five (585) feet. For the purposes of further

defining the term "horizontal wells" and "horizontally drilled" reference is made to the definitions contained within Statewide Rule 86, as promulgated by the Railroad Commission of Texas, which definitions are incorporated herein for all purposes.

In the event of any partial termination of the Lease as provided in Paragraph 7A, then, with regard to a well which is a horizontal well or a horizontally drilled well, Lessee shall be entitled to retain all sands and horizons at all depths from the surface down to a depth which is the stratigraphic equivalent of a depth of one hundred (100) feet below the base of the deepest producing formation in such well which is capable of producing oil and gas in paying quantities, but only in a spacing unit the area or number of acres of which are equal to the area or number of acres determined by adding twenty (20) acres for each five-hundred eighty-five (585) feet horizontally drilled to the original forty (40) acres deemed to be a proration unit for each vertical well. Each such tract around each horizontally drilled well shall be as nearly in the shape of a square or a rectangle as is practical with the boundaries of the tract including the entire horizontal drainhole and the lateral boundaries of such tract being approximately equal distance from such drainhole and parallel thereto.

If production should thereafter cease as to acreage included in a proration unit or pooled unit, this Lease will terminate as to such acreage unless Lessee commences reworking or additional drilling operations on such acreage within ninety (90) days thereafter and continues such reworking or additional drilling operations until commercial production is restored thereon, provided that if more than ninety (90) days pass between the abandonment of such well and the commencement of actual drilling operations for an additional well, or more than ninety (90) days pass since the commencement of reworking operations without the restoration of commercial production, the Lease shall terminate as to the applicable proration unit.

At any time or times that this Lease terminates as to all or any portion of the acreage of the leased premises, Lessee shall promptly execute and record in the office of the County Clerk in the County where the leased premises are located, a proper release of such terminated acreage and shall furnish executed counterparts of each such release to Lessor at the address shown in Paragraph 19 hereof.

C. Oil Well

A gas well that becomes an oil well will hold only the acreage permitted for an oil well, and Lessee must file a redesignation of the held acreage in the real property records of the county where the leased premises is located. If Lessee fails to file timely a document required by this paragraph, then Lessor may do so and the filing will bind Lessee.

8.

OFFSET OBLIGATIONS

In the event a well or wells producing oil or gas should be brought in on adjacent or nearby land and such well is draining the leased premises, Lessee agrees within sixty (60) days from the commencement of production from such well or wells to commence the actual drilling of an offset well or wells on the leased premises; provided that the well or wells which are to be offset are producing in paying quantities. A well on land within five hundred (500) feet from any boundary of the leased premises shall be conclusively deemed to be draining the leased premises. In lieu of drilling an offset well, Lessee may release to Lessor, free of this Lease, the offsetting tract of at least one hundred twenty (120) acres.

9.

FORCE MAJEURE

A. The term "force majeure" as used herein shall mean and include: requisition,

order, regulation, or control by governmental authority or commission; exercise of rights or priority or control by governmental authority for national defense or war purpose resulting in delay in obtaining or inability to obtain either material, equipment or means of transportation normally necessary in prospecting or drilling for oil, gas or other mineral granted herein, or in producing, handling or transporting same from the leased premises; war, scarcity of or delay in obtaining materials or equipment; lack of labor or means of transportation of labor or materials; acts of God; insurrection; flood; strike; or other things beyond the control of Lessee. The term "force majeure" shall not include lack of markets for production or any other events affecting only the economic or financial aspects of drilling, development or production. Further, the failure or inability to obtain any action or approval required by a municipality in order to drill a well shall not extend the term of the lease by more than twelve (12) months.

B. Notwithstanding any other provisions of this Lease, but subject to the conditions hereinafter set forth in this Paragraph 9, should Lessee be prevented by "force majeure" as defined above, from conducting drilling or reworking operations on, or producing oil, gas or other mineral from, the leased premises, such failure shall not constitute a ground for the termination of this Lease or subject said Lessee to damages therefor; and the period of time during which Lessee is so prevented shall not be counted against Lessee, but this Lease shall be extended for a period of time equal to that during which such Lessee is so prevented from conducting such drilling or reworking operations on, or producing oil, gas or other mineral from, such leased premises provided, however, that in no event will the primary term be extended unless Lessee has begun the actual drilling of a well prior to the date of the expiration of the primary term. All of the provisions of this paragraph are subject to each of the following express conditions:

The terms and conditions of this paragraph shall not extend beyond the expiration date of

any law, order, rule or regulation invoked under this paragraph, and shall be applicable and effective only during the following periods:

(1) If the force majeure shall occur during the primary term of this Lease, it shall not operate to extend this Lease more than two (2) consecutive years beyond the expiration of the primary term.

(2) If the force majeure shall occur during a ninety (90) day drilling or reworking period provided for in Paragraphs 6 and 7 hereof, after the primary term has expired, then it shall not operate to extend the Lease more than two (2) successive years beyond the expiration of such ninety (90) day periods.

(3) In no event will the primary term be extended unless Lessee has begun the actual drilling of a well prior to the date of the expiration of the primary term.

C. None of the provisions of this paragraph shall ever be or become effective and applicable unless Lessee shall, within a reasonable time (not to exceed sixty (60) days in any event) after occurrence of the claimed event of force majeure above referred to, notify the Lessor, in writing, of such occurrence with full particulars thereof.

D. The terms of this paragraph do not apply to monetary payments due under the terms of this Lease.

10.

SHUT-IN GAS WELL PROVISIONS

If at any time while there is a gas well on the leased premises or land pooled therewith which is capable of producing gas in paying quantities, but the production thereof is shut-in or suspended for any reason, and if this Lease is not then continued in force by some other provision hereof, then this Lease shall nevertheless continue in force as to such well and the pooled unit or proration unit allocated to it for a period of sixty (60) days from the date such well is shut-in.

Before the expiration of any such sixty (60) day period, Lessee or any Assignee hereunder may pay or tender to the Lessor a shut-in royalty equal to Five Thousand Dollars (\$5,000.00) per shut-in gas well and if such payment or tender is timely made, this Lease shall continue in force but only as to said well or wells and the proration unit or the pooled unit allocated to it or them and it shall be considered that gas is being produced from said well or wells in paying quantities for one (1) year from the date such well or wells are shut-in, and in like manner one, and only one, subsequent shut-in royalty payment may be made or tendered and it will be considered that gas is being produced from said well or wells in paying quantities for such additional one (1) year period as well.

Lessee shall not be entitled to recover any shut-in royalty payments from the future sale of gas. Should such shut-in royalty payments not be made in a timely manner as provided in this section, it will be considered for all purposes that there is no production and no excuse for delayed production of gas from any such well or wells, and unless there is then in effect other preservation provisions of this Lease, this Lease shall terminate. Lessee shall pay or tender directly to the Lessor at the address as shown in Paragraph 19 all shut-in royalty payments as required by this Lease.

The obligation of Lessee to pay shut-in royalty as set forth herein is a condition to the continuation of this Lease and not a covenant.

11.

INFORMATION, ACCESS AND REPORTS

A. Lessor shall have free access at all times to all wells, tanks, and other equipment that services wells under the leased premises, including drilling wells, and Lessee agrees to furnish Lessor, or Lessor's nominee, currently and promptly, upon written request, with full well information including cores, cuttings, samples, logs (including Schlumberger and other electrical

logs), copies and results of deviation tests and directional and seismic surveys, and the results of all drill stem tests and other tests of other kind or character that may be made of wells on the leased premises. Lessor or Lessor's nominee shall be furnished with and have free access at all times to Lessee's books and records relative to the production and sale of oil, gas or other minerals from the leased premises, including reports of every kind and character to governmental authorities, State or Federal. Lessor shall have the right at its election to employ gaugers or install meters to gauge or measure the production of all minerals produced from the leased premises, and Lessee agrees to prepare and deliver to Lessor or Lessor's gauger or nominee duplicate run or gauge tickets for all minerals removed from the premises. Lessee shall furnish to Lessor copies of all applications to drill and daily drilling reports on each well drilled.

B. Lessee shall furnish to Lessor, within a reasonable time after its execution, a copy of any gas purchase contract or transportation agreement entered into in connection with the leased premises, or if there is already a gas purchase contract or transportation agreement in effect due to Lessee's operations in the field, then a copy of that contract. Furthermore, a copy of any amendments to the gas purchase contract or transportation agreement shall be furnished said Lessor within thirty (30) days after execution thereof; and on request of Lessor and without cost to the Lessor, Lessee shall furnish Lessor a copy of the following reports: core record, core analysis, well completion, bottom hole pressure measurement, directional survey records, electrical and induction surveys and logs, gas and oil ratio reports, paleontological reports pertaining to the paleontology of the formations encountered in the drilling of any wells on the leased premises, and all other reports which pertain to the drilling, completing or operating of the wells located on the leased premises. Such information shall be solely for Lessor's use, and Lessor shall in good faith attempt to keep same confidential for twelve (12) months after receipt

or until the information is available to the general public, whichever comes first.

C. Lessee shall advise Lessor in writing of the location of all wells drilled upon the leased premises on or before thirty (30) days prior to commencement of operations, and shall advise Lessor in writing the date of completion and/or abandonment of each well drilled within thirty (30) days after completion or abandonment.

12.

PRESERVATION OF ECOLOGY OF LEASED PREMISES

Any overflows or releases affecting the leased premises, including, but not limited to, salt water, mud, chemical, or oil shall be reported immediately to Lessor. Lessee shall not use any water in, on or under the leased premises without the prior written consent of the Lessor. Lessee will not implement any repressuring, pressure maintenance, recycling, or secondary recovery operation without the prior written consent of Lessor.

13.

REMOVAL OF EQUIPMENT

Lessee shall have the right at any time during or within six (6) months after the expiration of this Lease (but not thereafter) to remove all property and fixtures placed by Lessee on the leased premises, including the right to draw and remove all casing. This paragraph shall not apply to equipment or casing on or in an oil or gas well capable of producing in paying quantities, but Lessee shall be paid reasonable salvage value for any such casing or equipment. It is contemplated that Lessee may drill across and through lands covered by this agreement where production is not obtained or ceases. Where the casing or pipeline placed or laid through such non-producing lands is necessary to the production of a well or wells located on other lands covered by this Lease, or lands pooled therewith, it is expressly understood and agreed that Lessor will make no demand that such casing, pipelines or other equipment necessary for the production of a well or wells drilled by

Lessee be removed as long as such casing, pipelines and other equipment is necessary for the production of a producing well or wells drilled by Lessee.

14.

ASSIGNMENTS

A. Lessor is granting rights to Lessee that Lessor would not grant to others. Therefore, prior written approval of Lessor is required for any assignment or sublease of this Lease, which will not be unreasonably withheld. All assignments and subleases must require the assignee or sublessee to assume all of Lessee's obligations under this Lease.

B. Lessor has the right from time to time at Lessor's sole discretion to assign, sell, pledge, or transfer its interest in the Land in whole or in part.

15.

NO WARRANTY

This Lease is given and granted without warranty of title, express or implied, in law or in equity. By acceptance of this Lease, Lessee acknowledges that it has been given full opportunity to investigate and has conducted sufficient investigation to satisfy itself as to title to the leased premises, and Lessee assumes all risks of title failures. Lessor agrees that Lessee, at Lessee's option, may purchase or discharge, in whole or in part, any tax, mortgage or other lien upon the leased premises and thereupon be subrogated to the right of the holder thereof, and may apply royalties accruing hereunder toward satisfying same or reimbursing Lessee. It is also agreed that if Lessor owns an interest in the oil and gas under the leased premises less than the entire fee simple estate therein, the royalties to be paid Lessor shall be reduced proportionately, but in no event shall the shut-in royalty amount for a gas well, as provided for in Paragraph 10 hereof, be reduced. Lessee shall provide to Lessee a copy of all title opinions issued to or for the benefit of Lessee in

connection with the leased premises.

16.

INDEMNITY

Lessee shall expressly release and discharge, all claims, demands, actions, judgments, and executions which it ever had, or now has or may have, or assigns may have, or claim to have, against the Lessor or its departments, agents, officers, servants, successors, assigns, sponsors, volunteers, or employees, created by, or arising out of personal injuries, known or unknown, and injuries to property, real or personal, or in any way incidental to or in connection with the performance of the work performed by the Lessee. **The Lessee shall fully defend, protect, indemnify, and hold harmless the Lessor, its departments, agents, officers, servants, employees, successors, assigns, sponsors, or volunteers from and against each and every claim, demand, or cause of action and any and all liability, damages, obligations, judgments, losses, fines, penalties, costs, fees, and expenses incurred in defense of the Lessor, its departments, agents, officers, servants, or employees, including, without limitation, the payment of bonus and/or royalties regarding ownership of the Lessor's mineral interest of the leased premises which may be made or asserted by Lessee, its agents, assigns, or any third parties on account of, arising out of, or in any way incidental to or in connection with the ownership and title of the mineral interest of the Lessor under this Lease.**

The Lessee shall fully defend, protect, indemnify, and hold harmless the Lessor, its departments, agents, officers, servants, employees, successors, assigns, sponsors, or volunteers from and against each and every claim, demand, or cause of action and any and all liability, damages, obligations, judgments, losses, fines, penalties, costs, fees, and

expenses incurred in defense of the Lessor, its departments, agents, officers, servants, employees, successors, assigns, sponsors, or volunteers, including, without limitation, personal injuries and death in connection therewith which may be made or asserted by Lessee, its agents, assigns, or any third parties on account of, arising out of, or in any way incidental to or in connection with the performance of the work performed by the Lessee under this Lease.

THE LESSEE AGREES TO INDEMNIFY AND HOLD HARMLESS THE LESSOR, ITS OFFICERS, AGENTS, SERVANTS, EMPLOYEES, SUCCESSORS, ASSIGNS, SPONSORS, OR VOLUNTEERS FROM ANY LIABILITIES OR DAMAGES SUFFERED AS A RESULT OF CLAIMS, DEMANDS, COSTS, OR JUDGMENTS AGAINST THE LESSOR, ITS DEPARTMENTS, ITS OFFICERS, AGENTS, SERVANTS, EMPLOYEES, SUCCESSORS, ASSIGNS, SPONSORS, OR VOLUNTEERS, CREATED BY, OR ARISING OUT OF THE ACTS OR OMISSIONS OF THE LESSOR OCCURRING ON THE DRILL SITE OR OPERATION SITE IN THE COURSE AND SCOPE OF INSPECTING AND PERMITTING THE GAS WELLS INCLUDING, BUT NOT LIMITED TO, CLAIMS AND DAMAGES ARISING IN WHOLE OR IN PART FROM THE NEGLIGENCE OF THE LESSOR OCCURRING ON THE DRILL SITE OR OPERATION SITE IN THE COURSE AND SCOPE OF INSPECTING AND PERMITTING THE GAS WELLS. IT IS UNDERSTOOD AND AGREED THAT THE INDEMNITY PROVIDED FOR IN THIS SECTION IS AN INDEMNITY EXTENDED BY THE LESSEE TO INDEMNIFY AND PROTECT LESSOR AND/OR ITS DEPARTMENTS, AGENTS, OFFICERS, SERVANTS, EMPLOYEES, SUCCESSORS, ASSIGNS, SPONSORS, OR VOLUNTEERS FROM THE

CONSEQUENCES OF THE NEGLIGENCE OF THE LESSOR AND/OR ITS DEPARTMENTS, AGENTS, OFFICERS, SERVANTS, EMPLOYEES, SUCCESSORS, ASSIGNS, SPONSORS, OR VOLUNTEERS, WHETHER THAT NEGLIGENCE IS THE SOLE OR CONTRIBUTING CAUSE OF THE RESULTANT INJURY, DEATH, AND/OR DAMAGE.

17.

INSURANCE

Lessee shall provide or cause to be provided the insurance described in the City of Fort Worth Gas Ordinance for each well drilled under the terms of this Lease, such insurance to continue until the well is abandoned and the site restored. Such insurance shall provide that Lessor shall be a co-insured, without cost, and that said insurance can not be canceled or terminated without thirty (30) days prior notice to Lessor and ten (10) days notice to Lessor for nonpayment of premiums.

18.

RELEASES REQUIRED

Within thirty (30) days after the partial termination of this Lease as provided under any of the terms and provisions of this Lease, Lessee shall deliver to Lessor a plat showing the production units designated by Lessee, copies of logs showing depths to be retained within each unit, and a fully executed, recordable release properly describing by metes and bounds the lands and depths to be retained by Lessee around each producing well. If this Lease terminates in its entirety, then Lessee shall deliver a complete, fully executed, recordable release to Lessor within thirty (30) days. If such release complies with the requirements of this section, Lessor shall record such release. If Lessee fails to deliver a release complying with the requirements of this

section within thirty (30) days after Lessor's demand therefore, then Lessee shall pay Lessor an amount equal to Five Dollars (\$5.00) per acre per day for each acre of the leased premises that should have been released, beginning with the 30th day after the date of Lessor's request and continuing until such release has been executed and delivered to Lessor. It is agreed that actual damages to Lessor for Lessee's failure to deliver such release are difficult to ascertain with any certainty, and that the payments herein provided are a reasonable estimate of such damages and shall be considered liquidated damages and not a penalty. Furthermore, Lessor is hereby authorized to execute and file of record an affidavit stating that this Lease has expired and the reason therefor, and such affidavit shall constitute prima facie evidence of the expiration of this Lease or any part of this Lease.

19.

NOTICES

A. All notices, information, letters, surveys, reports, material, and all other documents, required or permitted to be sent to Lessor by Lessee shall be sent by certified United States mail, postage prepaid, return receipt required, to the following address:

Gateway Public Facility Corporation
P.O. Box 430
Fort Worth, Texas 76101

B. All notices required or permitted to be sent to Lessee by Lessor shall be sent to Lessee by certified United States mail, postage prepaid, return receipt requested to the following address:

Vargas Energy, Ltd.
4200 South Hulen, Suite 614
Fort Worth, Texas 76109

C. Service of notices, and other documents, hereunder is complete upon deposit of the mailed material in a post office or official depository under the care and custody of the United States Postal Service, in a postpaid, properly addressed and certified wrapper.

D. Any party hereto shall have the right to change the name or address of the person or persons required to receive notices, and other documents, by so notifying the other party in writing.

20.

BREACH BY LESSEE

Lessee shall conduct Lessee's operations in strict compliance with all of the terms and provisions of this Lease and with all applicable local, state and federal rules and the regulations of any regulatory body having jurisdiction of such operations including, but not limited to, all local, state and federal environmental rules and regulations and applicable city ordinances.

In the event Lessor considers that operations are not, at any time, being conducted in compliance with this Lease, or any implied covenant of this Lease, Lessor shall notify Lessee in writing of the facts relied upon as constituting a breach of any express or implied covenant or obligation of Lessee hereunder and, Lessee, if in default, shall have sixty (60) days after receipt of such notice in which to commence compliance with its obligations hereunder. Failure on the part of Lessee to timely commence efforts to rectify any such breach and to exercise diligence in remedying any such breach shall operate as a forfeiture of this Lease as to the portion thereof affected by such breach; provided that if Lessee, in good faith, disputes any alleged grounds of breach set forth in such notice, Lessee may, within said sixty (60) day period, institute a Declaratory Judgment Action in any District Court in a county where all or part of the said leased premises are located questioning whether it has in fact breached any expressed or implied covenant of this Lease, thereby staying any forfeiture during the pendency of such action. However, in the event that Lessor obtains a final judicial ascertainment in any such proceeding that Lessee is in breach of any covenant hereof, express or implied, then it is agreed that Lessor

shall be entitled to a decree providing for cancellation or forfeiture of the Lease in the event such breach is not rectified or commenced in good faith to be rectified by Lessee within thirty (30) days from date such decree becomes final.

21.

LOCATION OF DRILLING ACTIVITY, PIPELINES AND EQUIPMENT

There is a no surface use or occupancy lease. No drilling or other activity of any kind shall be conducted on the surface of the leased premises and no roads, electric lines, pipelines, equipment, or other structures shall be placed on the surface of the leased premises.

22.

COMPLIANCE WITH LAWS

Lessee shall comply with all applicable rules, regulations, ordinances, statutes and other laws in connection with any drilling, producing or other operations under the terms of this Lease, including, without limitation, the oil and gas well regulations of the City of Fort Worth and the rules of the Railroad Commission of Texas.

23.

CONFLICT OF INTEREST

Lessee represents that Lessee, its officers and directors, are not employees or officers of Housing Authority of the City of Fort Worth, Texas nor is Lessee (its officers and directors) acting on behalf of any such officer or employee of Housing Authority of the City of Fort Worth, Texas.

24.

TERMS

All of the terms and provisions of this Lease shall extend to and be binding upon the heirs, executors, administrators, successors and authorized assigns of the parties hereto.

25.

ENTIRE AGREEMENT

This Lease states the entire contract between the parties, and no representation or promise, verbal or written, on behalf of either party shall be binding unless contained herein; and this Lease shall be binding upon each party executing the same, regardless of whether or not executed by all owners of the above described land or by all persons above named as "Lessor", and, notwithstanding the inclusion above of other names as "Lessor", this term as used in this Lease shall mean and refer only to such parties as execute this Lease and their successors in interest. The execution or ratification by Lessor of any division order, gas contract, or any other document will not alter any provision of this Lease unless the intent to do so is expressly stated in the document.

26.

CAPTIONS

The captions to the various paragraphs of the Lease are for convenience only, to be used primarily to more readily locate specific provisions. They shall not be considered a part of the Lease, nor shall they be used to interpret any of the Lease provisions.

27.

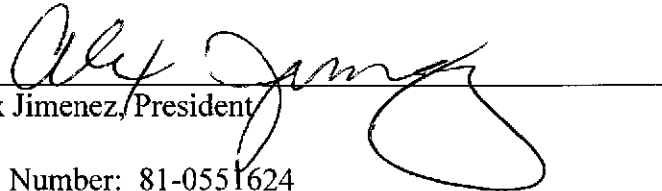
COUNTERPARTS

This Lease may be executed in multiple counterparts, each of which shall be deemed an original, with the same effect as if the signature thereto and hereto were upon the same instrument.

EXECUTED and effective as of the date of the notarial acknowledgment of the Lessor's execution.

LESSOR:


GATEWAY PUBLIC FACILITY CORPORATION

By: 
Alex Jimenez, President

Tax I.D. Number: 81-0551624

LESSEE:

VARGAS ENERGY, LTD.


By: 
Name: CRAWFORD EDWARDS
Title: President

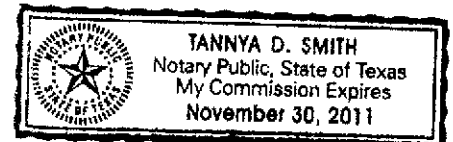
THE STATE OF TEXAS §
 §
COUNTY OF TARRANT §

BEFORE ME, the undersigned, a Notary Public, on this day personally appeared Alex Jimenez, President of Gateway Public Facility Corporation, known to me to be the person whose name is subscribed to the foregoing instrument and acknowledged to me that he has executed the same for the purposes and consideration therein expressed and in the capacity therein stated.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this 10th day of July, 2008.

[SEAL]

 Notary Public in and for the
State of Texas



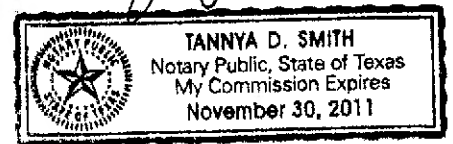
My Commission Expires: 11-30-11
Tannya D. Smith Print Name of Notary Public Here

THE STATE OF TEXAS §
 §
COUNTY OF Tarrant §

BEFORE ME, the undersigned, a Notary Public, on this day personally appeared Crawford Edwards, President of Vargas Energy, Ltd., known to me to be the person whose name is subscribed to the foregoing instrument and acknowledged to me that s(he) has executed the same for the purposes and consideration therein expressed and in the capacity therein stated.

GIVEN UNDER MY HAND AND SEAL OF OFFICE this 11th day of July, 2008.

[SEAL] Tannya D. Smith Notary Public in and for the
State of Texas



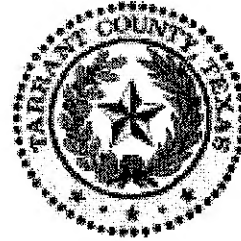
My Commission Expires: 11-30-11
Tannya D. Smith Print Name of Notary Public Here

Exhibit "A"

The property described in the deed from State of California Public Employees' Retirement System to Gateway Public Facility Corporation recorded in Volume 15710 at Page 257 of the Real Property Records of Tarrant County, Texas.

After recording, return to:

Mr. Larry W. Wilshire
Brown Dean
306 West 7th Street, Suite 200
Fort Worth, Texas 76102-4905



MR LARRY W WILSHIRE
306 WEST 7TH ST STE 200
BROWN DEAN
FT WORTH

TX 76102

Submitter: BROWN DEAN WISEMAN PROCTOR

SUZANNE HENDERSON
TARRANT COUNTY CLERK
TARRANT COUNTY COURTHOUSE
100 WEST WEATHERFORD
FORT WORTH, TX 76196-0401

DO NOT DESTROY
WARNING - THIS IS PART OF THE OFFICIAL RECORD.

Filed For Registration: 07/11/2008 02:36 PM
Instrument #: D208271174
LSE 36 PGS \$152.00

By: _____



D208271174

ANY PROVISION WHICH RESTRICTS THE SALE, RENTAL OR USE
OF THE DESCRIBED REAL PROPERTY BECAUSE OF COLOR OR
RACE IS INVALID AND UNENFORCEABLE UNDER FEDERAL LAW.

Printed by: MC